

## NOTE 20.

## CONTINGENT LIABILITIES

**Litigation:** The State is a party to numerous legal proceedings, many of which normally occur in governmental operations. The following were accrued as a liability in the financial statements: legal proceedings that were decided against the State before June 30, 1996; legal proceedings that were in progress as of June 30, 1996, and that were settled or decided against the State as of November 27, 1996; and legal proceedings having a high probability of resulting in a decision against the State as of November 27, 1996, and for which amounts could be estimated. For governmental fund types and expendable trust funds, the portion of the liability that is expected to be paid within the next 12 months is recorded as a liability of the fund from which payment will be made; the remainder is shown as a liability of the General Long-Term Obligations Account Group. For other fund types, the entire liability is recorded in the fund involved. In addition, the State is involved in certain other legal proceedings that, if decided against the State, may require the State to make significant future expenditures or may impair future revenue sources. Because of the prospective nature of these proceedings, no provision for this potential liability has been made in the financial statements.

Following are the more significant lawsuits pending against the State:

The State is involved in a lawsuit, *Thomas Hayes v. Commission on State Mandates*, related to state-mandated costs. The action involves an appeal by the Director of Finance from a 1984 decision by the State Board of Control (now succeeded by the Commission on State Mandates (Commission)). The Board of Control decided in favor of local school districts' claims for reimbursement for special education programs for handicapped students. The case was then brought to the trial court by the State and later remanded to the Commission for redetermination. The Commission has since expanded the claim to include supplemental claims filed by seven other educational institutions; the issuance of a final consolidated decision is anticipated sometime in early 1997. To date, the Legislature has not appropriated funds. The liability to the State, if all potentially eligible school districts pursue timely claims, has been estimated by the Department of Finance at more than \$1 billion.

The State is involved in a lawsuit related to contamination at the Stringfellow toxic waste site. In *United States, People of the State of California v. J. B. Stringfellow, Jr., et al.*, the State is seeking recovery for past costs of cleanup of the site, a declaration that the defendants are jointly and severally liable for future costs, and an injunction ordering completion of the cleanup. However, the defendants have filed a counterclaim against the State for alleged negligent acts. Because the State is the present owner of the site, the State may be found liable. Present estimates of the cleanup range from \$200 million to \$800 million.

The State is a defendant in a coordinated action involving 3,000 plaintiffs seeking recovery for damages caused by the Yuba River flood of February 1986. The trial court has found liability in inverse condemnation and awarded damages of \$500,000 to a sample of plaintiffs. The State's potential liability to the remaining plaintiffs ranges from \$800 million to \$1.5 billion. An appeal has been filed.

The State is a defendant in *California State Employees Association v. Wilson*, where the petitioners are challenging several budget appropriations in the 1994 and 1995 Budget Acts. The appropriations mandate the transfer of funds from the State Highway Account to the General Fund to reimburse the General Fund for debt service costs on two rail bond measures. The petitioners contend that the transfers violate the bond acts themselves and are requesting the monies be returned. The loss to the State's General Fund could be up to \$227 million.

In a similar case, *Professional Engineers in California Government v. Wilson*, the petitioners are challenging several appropriations in the 1993, 1994, and 1995 Budget Acts. The appropriations mandate the transfer of approximately \$262 million from the State Highway Account and \$113 million from the Motor Vehicle Account to the General Fund and appropriate approximately \$6 million from the State Highway Account to fund a highway-grade crossing program administered by the Public Utilities Commission. Petitioners contend that the transfers violate several constitutional provisions and request that the moneys be returned to the State Highway Account and Motor Vehicle Account.

The State is a defendant in *Just Say No To Tobacco Dough Campaign v. State of California*, where the petitioners challenge the appropriation of approximately \$166 million of Proposition 99 funds in the Cigarette and Tobacco Products Surtax Fund for years ended June 30, 1990, through June 30, 1995 for programs which were allegedly not health education or tobacco-related disease research. If the State loses, the General Fund and funds from other sources would be used to reimburse the Cigarette and Tobacco Products Surtax Fund for approximately \$166 million.

The State is a defendant in the case of *Kurt Hathaway, et al. v. Wilson, et al.*, where the plaintiffs are challenging the legality of various budget action transfers and appropriations from particular special funds for years ended June 30, 1995, and June 30, 1996. The plaintiffs allege that the transfers and appropriations are contrary to the substantive law establishing the funds and providing for interest accruals to the fund, violate the single subject requirement of the State Constitution, and is an invalid "special law." Plaintiffs seek to have monies totaling approximately \$335 million returned to the special funds.

The State is a defendant in two related cases, *Beno vs. Sullivan* (Beno) and *Welch vs. Anderson* (Welch), concerning reductions in

Aid to Families with Dependent Children (AFDC) grant payments. In the Benoit case, plaintiffs seek to invalidate AFDC grant reductions and in the Welch case, plaintiffs contend that AFDC grant reductions are not authorized by state law. The Benoit case concerns the total grant reductions while the Welch case concerns the period of time the State did not have a waiver for those reductions. The State's potential liability for retroactive AFDC grant reductions is estimated at \$831 million if the plaintiffs are awarded the full amount in both cases.

The State was a defendant in *California Teachers Association v. Russell S. Gould, et al.*, where the petitioners challenged a recharacterization of \$1.1 billion of appropriations for the 1991-92 fiscal year and \$190 million in the 1992-93 fiscal year as emergency loans rather than Proposition 98 funds. The petitioners were seeking a declaration that all appropriated funds are Proposition 98 funds and, therefore, must be included in the minimum funding guarantee for schools. The trial court ruled that the appropriations are not Proposition 98 funds and should not be included in the minimum funding calculation in future years.

The petitioners also challenged the Legislature's appropriation of \$973 million to schools in the 1992-93 fiscal year and \$787 million to schools in the 1993-94 fiscal year. The appropriations, which the Legislature called "emergency loans," were in excess of the Proposition 98 guarantee of minimum funding; the Legislature explicitly excluded those excess funds from being included in the future Proposition 98 minimum funding guarantee. The trial court found that amounts which the State appropriated to schools as loans in excess of the Proposition 98 guarantee were considered to be Proposition 98 funding and were required to be used to calculate the Proposition 98 requirement in future years. Moreover, the trial court found that the State cannot require schools to repay the appropriations which were characterized as loans. The parties have reached a settlement which provides that both the State and K-14 schools share in the repayment of prior years' emergency loans to schools. Of the total \$1.8 billion in loans, the State will repay \$935 million by forgiveness of the amount owed, while schools will repay \$825 million. The \$935 million forgiveness of the amount owed is included as 1995-96 fiscal year expenditures of the General Fund. The State's share of the repayment will be reflected as an appropriation above the current Proposition 98 base calculation. The schools' share of the repayment will count as appropriations that count toward satisfying the Proposition 98 guarantee, or from "below" the current base.

**Federal Audit Exceptions:** The State receives substantial funding from the federal government in the form of grants and contracts. The State is entitled to these resources only if it complies with the terms and conditions of the grants and contracts and with the applicable federal laws and regulations; the State may spend these resources only for eligible purposes. If audits disclose exceptions, the State may incur a liability to the federal government.

**NOTE 21.**

**DEFERRED COMPENSATION PLANS**

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The State administers a long-term tax deferred savings program designed to supplement the retirement income of state employees. This program is comprised of a deferred compensation plan (457), in accordance with Section 457 of the Internal Revenue Code, and a thrift plan (401(k)), in accordance with Section 401(k) of the Internal Revenue Code. In addition, this program includes a mandatory retirement plan for employees covered by neither the Public Employees Retirement System (PERS) nor Social Security called the Part-Time, Seasonal and Temporary Plan (PST).

The 457 and 401(k) plans are optional plans for eligible employees. Employees under each plan defer receiving portions of their salaries, thereby deferring taxation on these portions, until they leave State service or face a serious financial emergency. Participants of the 457 and 401(k) plans direct the State to invest the deferred amounts among various investment options. The State makes no contribution to any of these plans and the cost of the program is paid through administrative fees by the program participants. The assets in the 457 plan remain the property of the employer until paid or made available to participants, subject only to the claims of the State's general creditors. The assets of the 401(k) plan are held for the participants in a trust.

The PST plan is a mandatory plan for employees who are not members of the State's retirement system and who are not covered by social security. The State invests PST plan participants' deferred amounts into an investment option of the State's choosing. The State makes no contribution to the PST plan, but the administrative costs to run the PST program are paid by the State.

The State of California has no liability for losses under the plans but does have the responsibility to administer the plans in good faith. As of June 30, 1996, the market value of the three plans was approximately \$2.5 billion for the 457 plan, \$293 million for the 401(k) plan, and \$42 million for the PST plan. The plans are accounted for as agency funds.

**NOTE 22.**

**PENSION TRUSTS**

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The State has two retirement systems: the California Public Employees' Retirement System (CalPERS) and the State Teachers' Retirement System (STRS).

CalPERS administers four defined benefit retirement plans: the Public Employees' Retirement Fund (PERF), the Judges' Retirement Fund (JRF), the Judges' Retirement Fund II (JRF II), and the Legislators' Retirement Fund (LRF). CalPERS also administers one defined benefit award plan, the Volunteer Firefighters' Length of

Service Award Fund (VFF). The financial report of CalPERS may be obtained by writing to the California Public Employees' Retirement System, Central Supply, P.O. Box 942715, Sacramento, California 94229-2715. STRS administers one defined benefit contributory retirement plan. The financial report of STRS may be obtained from the State Teachers' Retirement System, Accounting Division, 7667 Folsom Blvd., 2nd Floor, Sacramento, California 95826. The other pension funds are included in the fiduciary fund type.

*Standardized Measure of Pension Benefit Obligation:* Additional information for the State of California is presented during this transition period prior to the adoption of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*. This additional information includes the disclosure of the pension benefit obligation, as described below.

In order for users of governmental financial reports to assess the progress made in accumulating sufficient assets to pay benefits when due and to make comparisons among employers, GASB Statement No. 5 requires disclosure of a standardized measure called the pension benefit obligation (PBO). This measure is independent of the actuarial funding method used to determine employer contributions. The PBO is the actuarial present value of credited projected pension benefits (including projected future salary increases) estimated to be payable in the future as a result of employees' service to date.

The PBO for CalPERS was computed as part of an actuarial valuation performed as of June 30, 1995, which is the latest available valuation. The STRS PBO for June 30, 1996, was estimated based on the actuarial valuation as of June 30, 1995.

*Summary of Significant Accounting Policies - CalPERS:*

*Basis of Accounting:* CalPERS uses the accrual basis of accounting. Contributions are recorded when due. Investment income is recognized when earned, and expenditures are recorded when incurred.

*Investments:* CalPERS investments are presented at fair value. Statutes authorize CalPERS to invest in stocks, bonds, mortgages, real estate, and other investments. CalPERS maintains certain deposits, cash equivalents, and other investments with financial institutions.

The fair value of investments is based on published market prices and quotations from major investment brokers at current exchange rates, as available. Many factors are considered in arriving at that fair value. In general, however, corporate bonds are valued based on yields currently available on comparable securities of issuers with similar credit ratings. Investments in certain restricted common stocks are valued at the quoted market price of the issuer's unrestricted common stock, less an appropriate discount.

Mortgages have been valued on the basis of their future principal and interest payments discounted at prevailing interest rates for similar instruments. The fair value of real estate investments, principally rental property subject to long-term net leases, has been estimated based on independent appraisals. Short-term investments are reported at market value, when published market prices and quotations are available, or at cost plus accrued interest, which approximates market value. For investments where no readily ascertainable market value exists, management, in consultation with their investment advisors, have determined the fair values for the individual investments.

*Derivatives:* In accordance with statutes authorizing CalPERS investments, CalPERS, through its outside investment managers, holds investments in futures and options and enters into forward foreign currency exchange contracts. Futures and options of approximately \$20 million are held for investment purposes at June 30, 1996. Forward foreign currency exchange contracts are used primarily to hedge against changes in foreign equities, primarily denominated in European and Asian currencies. At June 30, 1996, CalPERS has approximately \$93 million net exposure to loss from forward foreign currency exchange transactions related to the \$20.2 billion international debt and equity portfolios.

CalPERS could be exposed to risk if the counterparties to the contracts are unable to meet the terms of the contracts. CalPERS anticipates that the counterparties will be able to satisfy their obligations under the contracts. CalPERS' investment managers seek to control this risk through counterparty credit evaluations and approvals, counterparty credit limits and exposure monitoring procedures.

*Related Party Investments:* CalPERS avoids related party investments as part of its written investment policy and no known related party investments exist in the fund.

*Actuarially Determined Funding Policy:* CalPERS uses a modification of the Entry Age Normal Actuarial Cost Method, which is a projected benefit cost method for PERF, LRF, JRF, and JRF II. That is, it takes into account those benefits that are expected to be earned in the future as well as those already accrued.

According to this cost method, the normal cost for an employee PBO is the level amount which would fund the projected benefit if it were paid annually from date of employment until retirement. CalPERS uses a modification of the Entry Age Normal Cost Method in which the employer's total normal cost is expressed as a level percentage of payroll. CalPERS also uses the level percentage of payroll method to amortize any unfunded actuarial liabilities. The amortization period of the unfunded actuarial liability is no longer than 17 years for school employees, 30 years for contracting public agencies, 35 years for the State of California, 40 years for LRF, and 6.5 years for



JRF. The VFF used the Unit Credit Actuarial Method as the basis for its valuation.

## **A. Public Employees' Retirement Fund**

### **1. Fund Information**

*Plan Description:* CalPERS administers the PERF, an agent multiple-employer retirement plan. Employers participating in the PERF include the State of California, 61 school employers, and 1,273 public agencies.

*Unfunded Pension Benefit Obligation:* The assets in excess of the PBO of PERF was \$3.1 billion at June 30, 1995. This is a result of the difference between the actuarial value of assets of \$83.8 billion and the PBO of \$80.7 billion. Contributions are actuarially determined.

### **2. State of California Information**

#### **Employers' Information - Contributions and Reserves**

*Plan Description:* The State of California contributes to the Public Employees' Retirement Fund (PERF), an agent multiple-employer public employee retirement system that acts as a common investment and administrative agent of the State of California and the other member agencies. The payroll for state employees covered by the PERF in the year ended June 30, 1996, was approximately \$8.9 billion. The total payroll for state employees in the year ended June 30, 1996 was approximately \$9.6 billion, not including the University of California.

All employees who work on a half-time basis or more are eligible to participate in the PERF. The PERF administers several different retirement plans, each providing a monthly allowance based on age, years of credited service, and highest average compensation over 12 consecutive months. Vesting occurs after five or ten years, depending on the plan. All plans provide death and disability benefits. The benefit provisions for the State are established by statute.

Costs of administering the Plan are financed through the contributions and investment earnings of the Plan.

*Employee and Employer Contribution Obligations:* State employees, with the exception of employees in the second-tier plan, are required to contribute to the fund. The contribution rates, based on the actuarial valuation, vary between plans. The required contribution rates of active plan members is based on a percentage of salary over a base compensation amount of \$238 to \$863 monthly. With the exception of employees in the second-tier plan, state employees required contributions vary from 5% to 8% of their salary over their base compensation amount.

For the year ended June 30, 1996, the required employer contribution rates are shown in Table 21.

**Table 21****Schedule of Required Contribution Rates for the State by Member Category**

June 30, 1996

	Normal Cost	Unfunded Liability	Total Rate
Miscellaneous members:			
First tier.....	9.415 %	2.935 %	12.350 %
Second tier.....	6.588	1.738	8.326
Industrial.....	9.824	(0.843)	8.981
California Highway Patrol.....	14.287	0.491	14.778
Police officers and Firefighters.....	14.631	(0.281)	14.350
Other safety members.....	14.107	0.121	14.228

*Funding Status and Progress:* The unfunded PBO for the State of California, as adjusted to fair value, based on the standardized measure of the PBO, which uses the Projected Unit Credit Actuarial Method, as appears in the actuarial valuation, was \$1.5 billion at June 30, 1995, as shown in Table 22.

**Table 22****Schedule of the Unfunded Pension Benefit Obligation for the State of California**

June 30, 1995 (Amounts in millions)

<b>Pension Benefit Obligation:</b>	
Retirees and beneficiaries currently receiving benefits and terminated employees not yet receiving benefits.....	\$ 18,478
Current employees:	
Accumulated employee contributions, including:	
allocated investment earnings.....	5,108
Employer-financed vested.....	12,366
Employer-financed nonvested.....	420
<b>Total pension benefit obligation.....</b>	<b>36,372</b>
Net assets allocated to fund the pension benefit obligation, at smoothed market value.....	34,889
<b>Unfunded Pension Benefit Obligation.....</b>	<b>\$ 1,483</b>

Following are the significant actuarial assumptions used to calculate the above PBO and the actuarially determined contributions presented in the next paragraph. The actuarially assumed investment return is 8.5% per annum. The salary scale used assumes salary increases that vary by length of service. The total increase in any future year includes an assumed 4.5% inflation rate, a 0.0% across the board increase and merit increases that vary by length of service. There was no change in the PBO as of June 30, 1995, as a result of changes in benefit provisions or actuarial methods and assumptions.



*Contributions Actuarially Determined and Contributions Made:* The total net retirement contributions for the year ended June 30, 1996, amounted to \$1.5 billion, of which \$1.1 billion or 12% of covered payroll came from the employers and \$0.4 billion or 4% of covered payroll came from the members. The actuarially determined required employer contributions will be reduced by approximately \$50 million due to the usage of surplus credits resulting from actuarial valuations. Contributions were made in accordance with actuarially determined requirements. Employer normal cost is 10.36% of covered payroll and amortization of unfunded liabilities is 1.82% of covered payroll. The State of California General Fund employer contribution for the year ended June 30, 1996, is \$587 million; this amount is not required to be paid until July 1, 1997.

*Trend Information:* Table 23 shows trend information for the PERF as of and for the years ended June 30, 1993, 1994, and 1995. Additional trend information is available in the separately issued financial report of CalPERS for the year ended June 30, 1996.

**Table 23**

**Schedule of Trend Information for the Public Employees' Retirement Fund**

As of and for the Years Ended June 30 (Amounts in millions)

	1995	1994	1993
Net assets available for benefits.....	\$ 34,889	\$ 32,550	\$ 27,477
Pension benefit obligation.....	36,372	33,552	31,560
Unfunded pension benefit obligation.....	1,483	1,002	4,083
Annual covered payroll.....	\$ 8,618	\$ 8,026	\$ 7,487
Employer Contributions.....	1,001	852	806
Percent funded.....	95.92 %	97.01 %	87.06 %
Unfunded pension benefit obligation as a percentage of covered payroll.....	17.21 %	12.48 %	54.53 %
Employer contributions as a percentage of covered payroll.....	11.62 %	10.62 %	10.77 %

## **B. Judges' Retirement Funds**

*Plan Description:* CalPERS administers the Judges Retirement Fund (JRF) and the Judges Retirement Fund II (JRF II), which are agent multiple employer defined benefit retirement plans. The membership of JRF includes justices of the Supreme Court and courts of appeal, and judges of superior courts and municipal courts appointed or elected prior to November 9, 1994. The membership of JRF II includes justices of the same courts who were appointed or elected subsequent to November 9, 1994. There are 59 employers participating in the JRF and 28 employers participating in the JRF II. The payroll for employees covered by JRF and JRF II in 1995 was approximately \$154 million and \$8 million respectively. The State of California pays the employer contributions for all employees covered by JRF and JRF II.

The required contribution rates of active plan members is based on a percentage of salary over a base compensation amount. For the year ended June 30, 1996, the required contribution rates for JRF and JRF II are 8.0%.

The funding to meet benefit payment requirements of JRF, other than member contributions, is currently provided from the following sources: employer contributions, which require 8.0% of applicable member compensation; filing fees, which require varying amounts, depending on fee rate and number of filings; investments, which earn the current yield on short-term investments; and the State of California balancing contributions, as required by the Judges' Retirement Law, which are equal to an amount at least equal to the estimated benefits payable during the ensuing fiscal year less the sum of (1) the estimated member contributions during the ensuing fiscal year, and (2) net assets available for benefits at the beginning of the fiscal year.

For the year ended June 30, 1996, the employer contribution rate for the JRF II was 18.8% of applicable member compensation. Costs of administering the plan are financed through the contributions and investment earnings of the plan.

All justices and judges are required to participate in the JRF and JRF II. JRF and JRF II provide a monthly allowance based on age, years of credited service, and highest average compensation over an established period of time of one year. Vesting occurs after five years. Both plans provide death and disability benefits. The benefits for the JRF are established by the Judges' Retirement Law. The benefits for the JRF II are established by the Judges' Retirement System II Law.

*Funding Status and Progress:* The unfunded PBO for the JRF, based on the standardized measure, which uses the Projected Unit Credit Actuarial Method as appears in the actuarial valuation at June 30, 1995 was \$1.3 billion, as shown in Table 24. An actuarial valuation has not been performed for JRF II using the standardized measure of PBO.

**Table 24**
**Schedule of the Unfunded Pension Benefit Obligation  
for the Judges' Retirement Fund**

June 30, 1995 (Amounts in millions)

**Pension Benefit Obligation:**

Retirees and beneficiaries currently receiving benefits and terminated employees not yet receiving benefits.....	\$ 785
Current employees:	
Accumulated employee contributions, including allocated investment earnings.....	97
Employer-financed vested.....	302
Employer-financed nonvested.....	129
<b>Total pension benefit obligation.....</b>	<b>1,313</b>
Net assets available for benefits at cost.....	9
<b>Unfunded Pension Benefit Obligation.....</b>	<b>\$ 1,304</b>

Following are the significant actuarial assumptions used to calculate the above PBO and the actuarially determined contributions presented in the next section. The actuarially assumed investment return is 8.5% per annum. The salary scale used assumes salary increases of 4.75% per annum. The total increase in any future year includes an assumed 4.5% inflation rate. There was no change in the PBO as of June 30, 1995, as a result of changes in benefit provisions or actuarial methods and assumptions.

Actuarial valuations for the JRF II are required to be carried out annually. The legislated State contribution rate will be adjusted periodically as part of the annual Budget Act in order to maintain or restore the actuarial soundness of the fund. The initial actuarial valuation was performed as of June 30, 1995. As of June 30, 1995, based on the actuarially determined funding policy, the fund was overfunded by approximately \$168,000. Also, for the year ended June 30, 1995, the total net contributions to the fund were \$239,000, which is greater than the actuarially determined required contributions.

*Contributions Actuarially Determined and Contributions Made:* The contribution requirements of the JRF are not actuarially determined. Contribution requirements are pursuant to state statute. An actuarial valuation of JRF's assets and liabilities is made at least every two years. The last valuation was performed as of June 30, 1995. Such valuations are used by CalPERS to make recommendations for financing the JRF. For JRF the normal cost is 15.89% of covered payroll. For the year ended June 30, 1995, the actual contributions made by the State to JRF were approximately \$50 million or 31% of the covered payroll, which is materially less than the actuarially determined contributions of approximately \$251 million, which is necessary to be fully funded by January 1, 2002. For the year ended June 30, 1995, actual contributions made by employees were \$12 million or 8% of covered payroll.

Contributions are actuarially determined for JRF II. The actuarial accrued liability was determined as part of an actuarial valuation of the retirement plan performed as of June 30, 1995, which is the latest available valuation. As of June 30, 1995, the statutory contribution rate for JRF II was 18.8% of covered payroll and there was no unfunded liability to amortize. The total net retirement contributions for JRF II for the year ended June 30 1996, amounted to \$2.1 million of which \$1.5 million or 18.8% of covered payroll came from employers and \$0.6 million or 8% of covered payroll came from members.

*Trend Information:* Table 25 shows trend information for the JRF as of and for the years ended 1993, 1994, and 1995. Table 25 reports the combined annual covered payroll of both JRF and JRF II, because the actuaries assume that the combined total will be the basis for the amortization of the unfunded past service liability. Additional trend information is available in the separately issued financial report of CalPERS for the year ended June 30, 1996.

**Table 25**

**Schedule of Trend Information for the Judges' Retirement Fund**  
As of and for the Years Ended June 30 (Amounts in millions)

	1995	1994	1993
Net assets available for benefits..... \$	9	\$ 15	\$ 24
Pension benefit obligation.....	1,313	1,200	1,315
Unfunded pension benefit obligation.....	1,304	1,185	1,291
Annual covered payroll..... \$	162	\$ 161	\$ 153
Employer and State General Fund contributions..	50	42	63
Percent funded.....	0.69 %	1.25 %	1.83 %
Unfunded pension benefit obligation as a percentage of covered payroll.....	804.94 %	736.02 %	843.79 %
Employer contributions as a percentage of covered payroll.....	30.86 %	26.09 %	41.18 %

**C. Legislators'  
Retirement Fund**

*Plan Description:* CalPERS administers the Legislators' Retirement Fund (LRF), which is an agent single-employer defined benefit retirement plan. The membership of LRF includes state legislators, constitutional officers and legislative statutory officers. The payroll for employees covered by LRF in 1995 was approximately \$4.6 million.

The required contribution rates of active plan members is based on a percentage of salary over a base compensation amount. For the year ended June 30, 1996, the required contribution rates for LRF was 4% of pay for members elected before March 4, 1972, and 8% of pay for members elected thereafter.

The required State contribution rate is 18.81% of applicable member compensation, for the year ended June 30, 1996. Costs of administering the plan are financed through the contributions and investment earnings of the plan.

All members are eligible to participate in the LRF. The LRF provides a monthly allowance based on age, years of credited service, and the highest compensation while in office. Vesting occurs after four years. The plan provides death and disability benefits. The benefits for the LRF are established by the Legislators' Retirement Law.

*Funding Status and Progress:* The unfunded PBO for the LRF based on the standardized measure of the PBO, which uses the Projected Unit Credit Actuarial Method as appears in the actuarial valuation at June 30, 1995, was \$10 million, as shown in Table 26.

**Table 26**

**Schedule of the Unfunded Pension Benefit Obligation for the Legislators' Retirement Fund**

June 30, 1995 (Amounts in thousands)

**Pension Benefit Obligation:**

Retirees and beneficiaries currently receiving benefits and terminated employees not yet receiving benefits.....	\$ 73,472
Current employees:	
Employee contributions.....	6,506
Employer-financed vested.....	15,409
Employer-financed nonvested.....	4,142
<b>Total pension benefit obligation.....</b>	<b>99,529</b>
Net assets available for benefits at cost (market value was \$93,612).....	89,156
<b>Unfunded Pension Benefit Obligation.....</b>	<b>\$ 10,373</b>

Following are the significant actuarial assumptions used to calculate the above PBO and the actuarially determined contributions presented in the following section. The actuarially assumed investment return is 7.75% per annum. The salary scale used assumes salary increases of 4.5% per annum. The total increase in any future year includes an assumed 4.5% inflation rate. There was no change in the PBO as of June 30, 1995, as a result of changes in benefit provisions or actuarial methods and assumptions.

*Contribution Required and Contribution Made:* The contribution requirements of the LRF are based on actuarially determined rates. An actuarial valuation of LRF's assets and liabilities is made at least every two years. The last valuation was performed as of June 30, 1995. As of June 30, 1995, the State funding rate was 18.81% of covered payroll. The amortization period of the unfunded actuarial liability is 40 years for the LRF. For the LRF, the normal cost is 26.23% of covered payroll and the amortization of unfunded liabilities is 12.09% of covered payroll, for a combined rate of

38.32% of covered payroll. For the year ended June 30, 1995, the actual state contributions made to the LRF were approximately \$576,000 or 12.5% of covered payroll, which is materially less than the actuarially determined required contributions of approximately \$1.9 million. For the year ended June 30, 1995, the actual contributions made by employees were approximately \$419,000 or 9% of covered payroll.

*Trend Information:* Table 27 shows trend information related to the LRF as of and for the years ended June 30, 1993, 1994, and 1995. Additional trend information is available in the separately issued financial report of CalPERS for the year ended June 30, 1996.

**Table 27****Schedule of Trend Information for the Legislators' Retirement Fund**

As of and for the Years Ended June 30 (Amounts in thousands)

	1995	1994	1993
Net assets available for benefits.....	\$ 89,156	\$ 82,417	\$ 72,695
Pension benefit obligation.....	99,529	97,248	95,104
Unfunded pension benefit obligation.....	10,373	14,831	22,409
Annual covered payroll.....	\$ 4,630	\$ 5,503	\$ 5,788
State contributions.....	576	596	698
Percent funded.....	89.58 %	84.75 %	76.44 %
Unfunded pension benefit obligation as a percentage of covered payroll.....	224.04 %	269.51 %	387.16 %
Employer contributions as a percentage of covered payroll.....	12.44 %	10.83 %	12.06 %

#### **D. Volunteer Firefighters' Length of Service Award Fund**

*Plan Description:* CalPERS administers the Volunteer Firefighters' Length of Service Award Fund (VFF), an agent multiple-employer public employee defined benefit award plan. It currently has 30 participating fire departments.

*Net Assets Available in Excess of Total Award Benefit Obligation:* The VFF did not have an unfunded benefit obligation at June 30, 1995. The net assets available in excess of total award benefit obligation for the VFF based on the standardized measure, which uses the Projected Unit Credit Actuarial Method as appears in the actuarial valuation at June 30, 1995, was \$116,000. This is the result of the difference between the net assets available for benefits of \$931,000 and the total award benefit obligation of \$815,000. The total award benefit obligation was determined as part of an actuarial valuation of the retirement plan performed as of June 30, 1995, which is the latest available valuation.

#### **E. State Teachers' Retirement System**

*Plan Description:* The State Teachers' Retirement System (STRS) is the administrator of the Teachers' Retirement Fund (TRF), a cost-sharing multiple-employer defined benefit retirement plan that provides pension benefits to teachers and certain other employees of



the California public school system. At June 30, 1996, the TRF had approximately 1,095 contributing employers, including school districts, community college districts, and county offices of education. The State is a nonemployer contributor to the TRF. The payroll for employees covered by TRF in 1996 was approximately \$13.3 billion.

For the year ended June 30, 1996, the required contribution rate for TRF covered members is 8% of applicable member earnings, and the required employer contribution rate is 8.25% of applicable member compensation.

Beginning July 1, 1991, full funding of TRF is provided by statute. The State's required annual contribution to the TRF is 4.3% of the previous calendar year's teacher payroll. Subsequent to achieving a full funding, the State will contribute only the amount necessary to help fund the normal cost.

In 1989, TRF was required by statute to provide distributions to retirees, disabilitants, and beneficiaries in order to restore purchasing power to a minimum of 68.2% of the initial monthly allowance. The statute required TRF to advance funds for the distribution, until such time as the state contributions were sufficient to meet the purchasing power obligations. The State is required to repay the amount of advances by TRF with interest. Full repayment to TRF is anticipated to occur by 1997. Additionally, under certain provisions of the California Education Code, employers are required to make contributions of 0.415% of the payroll to the State. These contributions are appropriated by the State to TRF.

Membership in the pension plan is mandatory for all employees meeting the eligibility requirements. This plan provides defined retirement benefits based on members' final compensation, age, and years of service. In addition, the retirement program provides benefits to members upon disability, and to survivors upon the death of eligible members. After five years of credited California service, members become 100% vested in retirement benefits earned to date. The benefits for the plan are established by the State Teachers' Retirement Law.

*Summary of Significant Accounting Policies:*

*Basis of Accounting:* The accounting records of the STRS are maintained on the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Employer and State contributions are recognized when due and the employer or State has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the STRS retirement program.

*Investments:* The majority of the securities held in the investment

portfolio at June 30, 1996, are in the custody of or controlled by the State Street Bank and Trust Company, the master custodian of the STRS. The investments of the STRS consist of government, corporate, and international bonds, domestic and international equities, mutual funds, limited partnerships holdings, real estate, mortgages and other investments.

All investments are recorded at fair value. The fair values of investments are generally based on published market prices and quotations from major investment firms. In the case of debt securities acquired through private placements, fair value is computed by management based on market yields and average maturity dates of comparable quoted securities. Mortgages are valued on the basis of future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. Real estate equity investment fair values represent the most recent independent appraisals (conducted in the year ended June 30, 1996), updates to appraisals for the year ended June 30, 1995, of properties purchased prior to the year ended June 30, 1996, and current value estimates for properties purchased in the current year. Short-term investments are reported at cost, which approximates fair value.

Purchase and sales of debt securities, equity securities, and short-term investments are recorded on the trade date. Real estate equity transactions are recorded on the settlement date. Upon sale of investments, the difference between sales proceeds and historical cost is reflected in the statement of changes in fund balance.

Debt discounts are accredited to the bond maturity date and premiums are amortized to the earliest call date using an approximation of the interest method. Mortgage loan discounts are accreted over a 20-year period using the pay-down method.

*Funding Status and Progress:* The unfunded PBO for the TRF based on the standardized measure of the PBO, which uses the Projected Unit Credit Actuarial Method as appears in the estimate for June 30, 1996 based on the actuarial valuation at June 30, 1995, was \$848 million, as shown in Table 28.

**Table 28**
**Schedule of the Unfunded Pension Benefit Obligation for  
the Teacher's Retirement Fund**

June 30, 1996 (Amounts in millions)

<b>Pension Benefit Obligation:</b>	
Retirees and beneficiaries currently receiving benefits and terminated employees not yet receiving benefits.....	\$ 27,885
Current employees:	
Accumulated employee contributions, including allocated investment earnings.....	15,904
Employer-financed vested.....	19,894
Employer-financed nonvested.....	620
<b>Total pension benefit obligation.....</b>	<b>64,303</b>
Net assets available for benefits at fair value.....	63,455
<b>Unfunded Pension Benefit Obligation.....</b>	<b>\$ 848</b>

Following are the significant actuarial assumptions used to calculate the above PBO. The fair market value of assets is the asset valuation method. The actuarially assumed investment return is 8.0% per annum. The salary scale used assumes salary increases of 5.5% per annum. The total increase in any future year includes an assumed 4.5% inflation rate. There was no change in the PBO as of June 30, 1996, as a result of changes in benefit provisions or actuarial methods and assumptions.

*Contribution Required and Contribution Made:* The contribution requirements of the TRF are not actuarially determined. The contribution requirements of the TRF are determined by statute. STRS employs an actuary to determine the adequacy of the funding of the plan, including the contribution levels. Based on the June 30, 1996 estimate, STRS independent actuaries determined that the estimated amortization period for the unfunded obligation computed using the cost method and the statutory contribution rates was 18 years from July 1, 1995. The annual required contribution by employers and the State for the year ended June 30, 1996, equaled the total amount contributed of \$1.7 billion. The employers' annual required contribution equaled \$1.2 billion, or 9.02% of covered payroll. The annual required contribution of the State was \$530 million, or 3.98% of covered payroll. Employees contributed \$1.1 billion, or 8.27% of covered payroll.

In addition to the \$530 million, the State made contributions to the TRF of approximately \$225 million for state mandates and to repay advances which provided for the restoration of the purchasing power of retirees, disabilitants, and beneficiaries.

An actuarial valuation of TRF's assets and liabilities is made at least every two years. The last valuation was performed as of June 30, 1995.

*Trend Information:* Table 29 shows trend information related to the

TRF as of and for the years ended 1994, 1995, and 1996. Additional trend information is available in the separately issued financial report of the STRS for the year ended June 30, 1996.

**Table 29****Schedule of Trend Information for the Teachers' Retirement Fund**

As of and for the Years Ended June 30 (Amounts in millions)

	1996	1995	1994
Net assets available for benefits.....	\$ 63,455	\$ 55,862	\$ 47,631
Pension benefit obligation.....	64,303	59,986	57,049
Unfunded pension benefit obligation.....	848	4,124	9,418
Annual covered payroll.....	\$ 13,300	\$ 12,688	\$ 12,251
State Contributions.....	755	733	759
Percent funded.....	98.68 %	93.13 %	83.49 %
Unfunded pension benefit obligation as a percentage of covered payroll.....	6.38 %	32.50 %	76.88 %
Employer contributions as a percentage of covered payroll.....	5.68 %	5.78 %	6.20 %

**NOTE 23.****POST-RETIREMENT HEALTH CARE BENEFITS**

In addition to providing pension benefits, the State provides health care and dental benefits to annuitants of retirement systems to which the State contributes as an employer. To be eligible for these benefits, first-tier plan annuitants must retire from the State on or after attaining age 50 with at least five years of service, and second-tier plan annuitants must retire from the State on or after attaining age 55 with at least 10 years of service. In addition, annuitants must retire within 120 days of separation from state employment to be eligible to receive these benefits. As of June 30, 1996, approximately 93,000 annuitants were enrolled to receive health benefits and approximately 88,000 annuitants were enrolled to receive dental benefits. In accordance with the Government Code, the State generally pays 100% of the health insurance cost for annuitants plus 90% of the additional premium required for the enrollment of family members of annuitants. Although the State generally pays 100% of the dental insurance premium for annuitants, the Government Code does not specify the State's contribution toward dental insurance costs. The State recognizes the cost of providing health and dental insurance to annuitants on a pay-as-you-go basis. The cost of these benefits for the year ended June 30, 1996, was approximately \$267 million. This amount decreased over the previous year due to a decrease in health insurance premiums.

**NOTE 24.****SUBSEQUENT EVENTS**

The following information represents significant events that occurred subsequent to June 30, 1996, but prior to the date of the auditors' report.

On August 6, 1996, the State issued \$3.0 billion in revenue anticipation notes that will mature on June 30, 1997. On November 7, 1996, the State issued \$129 million in general obligation bonds and \$371 million in general obligation refunding bonds, which were used to retire previously issued commercial paper. From July 1, 1996, to November 27, 1996, the State issued approximately \$549 million in revenue bonds. Refunding bonds that are used to refinance existing debt accounted for approximately \$499 million of the revenue bonds.

In the general election held on November 5, 1996, voters approved the sale of general obligation bonds with the passage of Propositions 204 and 206. Proposition 204, the "Safe, Clean, Reliable Water Supply Act," authorizes the issuance of \$995 million in bonds. Proposition 206, the "Veterans' Bond Act of 1996," authorizes the issuance of \$400 million in bonds.

**NOTE 25.****BUILDING AUTHORITIES**

**Building Authorities** have been created through the use of Joint Exercise of Powers Agreements with various cities to finance the construction of state buildings. The building authorities are legally separate from the State of California. They meet the criteria of blended component units and are being reported as capital projects funds. As a result, the capital lease arrangements between the building authorities and the State of \$320 million have been eliminated from the combined balance sheet. Instead, only the underlying fixed assets and the debt used to acquire them are reported in the appropriate account groups. Information on revenue bonds and certificates of participation are included in Note 15 and Note 10, respectively. Below is a list and description of these five building authorities:

The **Oakland State Building Authority** was created in 1994 by a Joint Exercise of Powers Agreement (JPA) between the State, acting through the director of the Department of General Services, and the Oakland Redevelopment Agency, for the purpose of financing the acquisition of land and to plan, design, and complete the construction of the Elihu M. Harris Building, as well as the leasing and financing required to accomplish these goals and administer these tasks. Copies of the financial statements may be obtained from the Oakland State Building Authority, 300 Lakeside Drive, Suite 130, Oakland, California 94612-3534.

The **East Bay State Building Authority** was created in 1989 by a JPA between the Department of General Services, the Department of

Transportation, and the City of Oakland for the purpose of financing the acquisition of land and the construction of a Department of Transportation state office building and parking facilities. Copies of the financial statements may be obtained from the East Bay State Building Authority, 111 Grand Avenue, Oakland, California 94612.

The **Los Angeles State Building Authority** was created in 1982 by a JPA between the State, acting through the director of the Department of General Services, and the Community Redevelopment Agency of the City of Los Angeles, for the purpose of financing the construction of a Los Angeles state office building. Copies of the financial statements may be obtained from the Los Angeles State Building Authority, 300 South Spring Street, Los Angeles, California 90013.

The **San Francisco State Building Authority** was created in 1982 by a JPA between the State, acting through the director of the Department of General Services, and the Redevelopment Agency of the City and County of San Francisco, for the purpose of financing the acquisition of land and the design and construction of a state building. Copies of the financial statements may be obtained from the San Francisco State Building Authority, San Francisco Redevelopment Agency, 770 Golden Gate Avenue, San Francisco, California 94102.

The **California State University and Colleges Headquarters Building Authority** was created in 1972 by a JPA between the City of Long Beach and the Trustees of the California State University and Colleges for the purpose of acquiring, constructing, maintaining, operating, leasing, and subleasing buildings for public education purposes. This includes a headquarters building for the Trustees. Copies of the financial statements may be obtained from the California State University and Colleges Headquarters Building Authority, 400 Golden Shore, Suite 102, Long Beach, California 90802-4275.

#### NOTE 26.

#### DISCRETELY PRESENTED COMPONENT UNITS

##### A. University of California

The University of California (UC) was founded in 1868 as a public, State-supported institution. The California State Constitution grants the UC full powers of government, subject only to legislative control necessary to ensure the security of its funds and compliance with certain administrative requirements. The majority of the 26-member independent governing board—the Regents of the University of California—are appointed by the Governor and approved by the state Senate. In addition, various UC programs and capital outlay projects are funded through appropriations from the State's annual Budget Act. The UC is discretely presented in the State's general purpose financial statements. Copies of the UC's separately issued financial statements may be obtained from the University of California, Business and Finance, 21st Floor, 300 Lakeside Drive, Oakland, California 94612-3550.



*Basis of Presentation:* The financial statements of the UC have been prepared in conformity with GAAP, as outlined in Governmental Accounting Standards Board (GASB) Statement No. 15 and the American Institute of Certified Public Accountants College Guide Model, including all applicable GASB statements effective for the fiscal years through June 30, 1996.

The UC has entered into various capital lease agreements with the State Public Works Board. The State Public Works Board issues revenue bonds to finance the construction of these leased facilities. The UC records the liability and the related trustee investments and fixed assets in the financial statements. For the year ended June 30, 1996, the outstanding liability recorded as capital leases was \$1.1 billion. This amount represents the total liability for the revenue bonds issued by the State Public Works Board to finance the construction of facilities for the UC.

*Investments:* Investments of all funds are stated at cost at the date of acquisition or, in the case of gifts, at quoted market value at the date of donation, with the exception of University of California Retirement System (UCRS) investments, which are stated at market value.

Substantially all of the UC's investments are held in funds associated with the Short Term Investment Pool (STIP), the General Endowment Pool (GEP), or UCRS. Investments authorized by the Regents for the STIP include fixed income securities with a maximum maturity of five years. Certain other investments which amount to \$582 million are held by the trustees, but are not included in Table 30. In addition, the Regents have also authorized loans to faculty members under the University's Mortgage Origination Program with terms up to 30 years. Investments authorized for the GEP and UCRS include equities and fixed-income securities. The equity portion of the investment portfolio may include common stocks, venture capital partnerships, and emerging market funds. Where donor agreements place constraints on allowable investments, assets associated with endowment and similar funds are invested in accordance with the terms of the agreements.

All of the UC's fund groups participate in the STIP. Current funds to provide for the payroll, operating expenses, and construction expenditures of all campuses and teaching hospitals are invested in the STIP until expended. These investments had a carrying value of \$3.5 billion and a market value of \$3.6 billion as of June 30, 1996. In the prior year, the STIP investments were recorded in the cash and pooled investments account. For this year, STIP investments are included in the investment account.

The GEP is a balanced portfolio in which a large number of individual endowment funds participate in order to benefit from diversification and economies of scale. These investments had a

carrying value of \$1.2 billion and a market value of \$2.4 billion as of June 30, 1996. The net assets of the endowment and similar funds group are either invested in the GEP or are separately invested. The separately invested funds that cannot be pooled in the GEP due to investment restrictions or income requirements had a carrying value of \$123 million, and a market value of \$173 million, as of June 30, 1996.

UCRS contains funds associated with the UC's defined benefits and defined contribution plans.

All of the UC's categorized investments are insured, registered or held by the UC's custodial bank as an agent for the UC in the UC's name. There are three categories of credit risk and the investments of the UC are category 1 investments. For an explanation of the various categories of credit risk, see Note 3. Table 30 presents the investments as of June 30, 1996.

**Table 30****Schedule of Carrying Value of Investments by Fund Group**

June 30, 1996 (Amounts in thousands)

Investment Type	Current Funds	Loan Funds	Endowment and Similar Funds	Plant Funds	Total Cost	Market Value	UCRS Market Value
Corporate equity securities.....	\$ 425	\$ —	\$ 760,979	\$ —	\$ 761,404	2,012,416	19,014,691
U.S. and state government							
Obligations.....	1,120,915	20,958	309,985	342,412	1,794,270	1,865,275	4,050,410
Corporate debt securities.....	864,121	16,156	290,357	263,968	1,434,602	1,438,719	1,660,547
Foreign government							
obligations.....	2,200	36	101,903	804	104,943	106,362	1,122,150
Foreign debt securities.....	—	—	69,663	—	69,663	75,886	603,047
Venture capital.....	—	—	41,001	—	41,001	47,938	365,624
Mutual funds.....	—	—	49,070	—	49,070	59,015	289,320
Mortgage loans.....	174,632	—	2,789	2,453	179,874	179,264	—
Insurance contracts.....	—	—	—	—	—	—	157,899
Other investments.....	3,087	—	8,523	7,240	18,850	18,850	—
<b>Total Investments.....</b>	<b>\$ 2,165,380</b>	<b>\$ 37,150</b>	<b>\$ 1,634,270</b>	<b>\$ 616,877</b>	<b>\$ 4,453,677</b>	<b>\$ 5,803,725</b>	<b>\$ 27,263,688</b>

Cash deposits held in bank accounts at June 30, 1996, totaled approximately \$52 million. Of this amount, \$500,000 was insured by the FDIC.

Investments of \$284 million included in the plant funds group are held by trustees and pledged for future payments of principal, interest, construction, and renewal and replacement in accordance with various indenture requirements and other long-term debt agreements.

The UC participates in a securities lending program as a means to augment income. At June 30, 1996, securities with a market value of approximately \$5.0 billion were on loan to brokerage firms.

*Due from Primary Government:* The Due from Primary Government account balance reflects \$111 million that is the short-term portion of the amount due to UC for administrative expenses from the General Fund and special revenue funds.

*Revenue Bonds and Other Long-Term Debt:* Revenue bonds are secured by the revenues of the individual projects as well as certain other UC revenues. Certificates of participation have been issued to finance buildings and equipment under lease agreements. The certificates are secured by buildings and equipment.

Table 31 shows the aggregate maturities of long-term debt for each of the years subsequent to June 30, 1996.

**Table 31**

**Schedule of University of California Long-Term Obligations**  
(Amounts in thousands)

Year Ending June 30	Capital Leases	Revenue Bonds	Mortgages and Other Borrowings
1997.....	\$ 126,897	\$ 23,790	\$ 231,988
1998.....	116,722	32,215	43,297
1999.....	111,889	40,390	35,155
2000.....	105,106	44,505	38,444
2001.....	98,873	47,850	30,081
Thereafter.....	1,549,310	1,678,000	477,777
	<b>2,108,797</b>	<b>\$ 1,866,750</b>	<b>\$ 856,742</b>
Less: Interest component of future minimum payments.....	928,204		
<b>Present value of future minimum payments.....</b>	<b>\$ 1,180,593</b>		

The above liabilities do not include \$1.1 billion of various defeased liabilities. Investments which have maturities and interest rates sufficient to fund retirement of these liabilities are being held in irrevocable trusts for the debt service payments. Neither the assets of the trusts nor the outstanding obligations are included in the balance sheet.

**University of California Retirement System**

*Plan Description:* Most UC career employees participate in the University of California Retirement System (UCRS). UCRS consists of a single-employer, defined benefit plan funded with UC and employee contributions; a defined benefit plan for UC employees who elected early retirement under the PERS Voluntary Early Retirement Incentive Program (PERS-VERIP); and two defined contribution plans with several investment portfolios funded with employee non-elective and elective contributions.

*Funding Policy:* UCRS is funded through UC and employee contributions. The annually determined rates for employer contributions as a percentage of payroll are based on recommendations of the consulting actuary and appropriations received from the State. Employer contributions were not required during the fiscal year ended June 30, 1996.

As of June 30, 1996, the total net assets available in excess of the PBO for covered employees is determined as shown in Table 32:

**Table 32**


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**Schedule of the Net Assets Available in Excess of the Pension Benefit Obligation**

June 30, 1996 (Amounts in thousands)

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**Pension Benefit Obligation:**

Retirees and beneficiaries currently receiving benefits and terminated employees not yet receiving benefits.....	\$ 7,514,400
Current employees:	
Employee contributions.....	755,600
Employer-funded vested.....	7,284,800
Employer-funded nonvested.....	522,700
<b>Total pension benefit obligation.....</b>	<b>16,077,500</b>
Actuarially determined assets available for benefits (market value of \$23,742,000).....	19,735,600
<b>Net assets available in excess of the pension benefit obligation.....</b>	<b>\$ 3,658,100</b>

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*Post-retirement Health Care Benefits:* In addition to pension benefits, the UC provides certain health plan benefits to retired employees. Employees who meet specific requirements may continue their medical and dental benefits into retirement and continue to receive UC contributions for those benefits. There are approximately 34,000 retirees currently eligible to receive such benefits. The cost of retiree medical and dental coverage is recognized when paid. The cost of providing medical and dental benefits for retirees and their families and survivors in the year ended June 30, 1996, was \$91 million.

*Commitments and Contingencies:* As of June 30, 1996, the UC had authorized construction projects totaling \$1.0 billion.

The UC is contingently liable in connection with claims and contracts, including those currently in litigation, arising in the normal course of its activities. UC management and General Counsel are of the opinion that the outcome of such matters will not have a material effect on the financial statements.

Rental expenditures for operating leases totaled \$93 million during the year ended June 30, 1996. Minimum required payments for the year ended June 30, 1997, are \$51 million. These payments will decrease in subsequent years.

*Subsequent Event:* In July 1996, Hospital Revenue Bonds totaling \$346 million were issued for the purpose of financing and refinancing the costs of the acquisition, construction and equipping of certain health care and related facilities at the University of California, Davis Medical Center. Approximately \$112 million of the proceeds were applied to repay interim financing incurred prior to the issuance of the bonds. The bonds have annual principal and semiannual interest payments, an average interest rate of six percent, serial maturities, term bonds with sinking fund requirements and optional redemption provisions.

## **B. Special Purpose Authorities**

The **State Compensation Insurance Fund (SCIF)** is a self-supporting enterprise created to offer insurance protection to employers at the lowest possible cost. It operates in competition with other insurance carriers to provide services to the State, county, city, school district, or other public corporations. The SCIF is legally separate from the State. It is a component unit of the State because the State appoints all five voting members of the SCIF's governing board and has the authority to approve or modify the budget for support of the SCIF to run the workers' compensation benefit program. Copies of the SCIF's financial statements may be obtained from the State Compensation Insurance Fund, 1275 Market Street, San Francisco, California 94103.

The **California Housing Finance Agency (CHFA)** was created for the purpose of meeting the housing needs of persons and families of low and moderate income by providing a low-cost source of financing. Copies of the CHFA financial statements may be obtained from CHFA, 1121 L Street, Sacramento, California 95814.

State legislation created various other **Non-Major Component Units** to provide certain services outside the State and to provide certain private and public entities with a low-cost source of financing for programs deemed to be in the public interest. Non-Major Component Units are legally separate from the State, provide services outside of the State, and meet the other criteria of discretely presented component units. Any debt of the Non-Major Component Units is collateralized solely by the credit of the private and public entities and is administered by trustees independent of the State or the State Treasurer's Office. At June 30, 1996, the Non-Major Component Units had \$10.4 billion of debt outstanding, which is not debt of the State. Copies of the financial statements of these component units may be obtained from the Office of the State Controller, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250-5876.

Tables 33 and 34 present summary financial statements for all major discretely presented component units and aggregate information for the Non-Major Component Units.

**Table 33**
**Condensed Balance Sheet**  
**Component Units – Special Purpose Authorities**

June 30, 1996 (Amounts in thousands)

	State Compensation Insurance	California Housing Finance Agency	Non-Major Component Units	Total
<b>Assets:</b>				
Due from primary government.....	\$ 9,965	\$ —	\$ 3,546	\$ 13,511
Due from other funds.....	—	—	739	739
Other current assets.....	1,114,452	395,345	138,555	1,648,352
Investments.....	5,913,923	975,760	4,098	6,893,781
Advances and loans receivable.....	—	3,731,656	4,478	3,736,134
Fixed assets.....	219,548	—	311,908	531,456
<b>Total Assets.....</b>	<b>\$ 7,257,888</b>	<b>\$ 5,102,761</b>	<b>\$ 463,324</b>	<b>\$ 12,823,973</b>
<b>Liabilities:</b>				
Due to other funds.....	\$ —	\$ —	\$ 743	\$ 743
Other current liabilities.....	1,043,830	303,519	20,351	1,367,700
Benefits payable.....	4,619,802	—	—	4,619,802
Revenue bonds payable.....	—	4,337,755	—	4,337,755
Contracts and notes payable..	—	—	48,853	48,853
<b>Total Liabilities.....</b>	<b>5,663,632</b>	<b>4,641,274</b>	<b>69,947</b>	<b>10,374,853</b>
<b>Fund Equity:</b>				
Retained earnings:				
Reserved for regulatory requirements.....	100,000	416,893	—	516,893
Unreserved.....	1,494,256	44,594	393,377	1,932,227
<b>Total Fund Equity.....</b>	<b>1,594,256</b>	<b>461,487</b>	<b>393,377</b>	<b>2,449,120</b>
<b>Total Liabilities and Fund Equity.....</b>	<b>\$ 7,257,888</b>	<b>\$ 5,102,761</b>	<b>\$ 463,324</b>	<b>\$ 12,823,973</b>



**Table 34****Combined Statement of Revenues, Expenses, and Changes in Retained Earnings****Component Units - Special Purpose Authorities**

Year Ended June 30, 1996 (Amounts in thousands)

	State Compensation Insurance	California Housing Finance Agency	Non-Major Component Units	Total
<b>Operating Revenues:</b>				
Earned premiums (net).....	\$ 1,077,384	\$ —	\$ —	\$ 1,077,384
Other revenue.....	—	366,085	110,161	476,246
<b>Total Operating Revenues.....</b>	<b>1,077,384</b>	<b>366,085</b>	<b>110,161</b>	<b>1,553,630</b>
<b>Operating Expenses:</b>				
Depreciation.....	7,641	600	3,311	11,552
Benefit payments.....	953,491	—	—	953,491
Interest expense.....	—	274,501	—	274,501
Amortization of deferred charges.....	—	2,238	—	2,238
Other operating expenses.....	175,441	40,821	120,024	336,286
<b>Total Operating Expenses.....</b>	<b>1,136,573</b>	<b>318,160</b>	<b>123,335</b>	<b>1,578,068</b>
<b>Operating Income (Loss).....</b>	<b>(59,189)</b>	<b>47,925</b>	<b>(13,174)</b>	<b>(24,438)</b>
<b>Nonoperating Revenues (Expenses):</b>				
Interest revenue.....	489,345	—	820	490,165
Dividends paid.....	(281,513)	—	—	(281,513)
Other nonoperating revenues (expenses).....	—	—	(6,236)	(6,236)
<b>Net Nonoperating Revenues (Expenses).....</b>	<b>207,832</b>	<b>—</b>	<b>(5,416)</b>	<b>202,416</b>
<b>Net Income (Loss).....</b>	<b>148,643</b>	<b>47,925</b>	<b>(18,590)</b>	<b>177,978</b>
<b>Retained Earnings, July 1, 1995.....</b>	<b>1,445,613</b>	<b>413,562</b>	<b>411,967</b>	<b>2,271,142</b>
<b>Retained Earnings, June 30, 1996.....</b>	<b>\$ 1,594,256</b>	<b>\$ 461,487</b>	<b>\$ 393,377</b>	<b>\$ 2,449,120</b>

**Significant Accounting Policies:** The SCIF prepares its financial statements in conformity with practices prescribed by the State's Department of Insurance, which is primarily in accordance with generally accepted accounting principles. There are, however, a few principal exceptions; policy acquisition costs, late premiums, and office furniture and equipment are charged off currently; premium income is recognized over the policy periods; reinsured contract amounts are presented net of reinsurance; and the amount, that is due from the primary government for claims received, is not recorded. The Board of Directors of the SCIF declares dividends payable to policy holders who meet the premium volume and loss experience criteria established by the Board. The dividends paid shown on the Statement of Revenues, Expenses, and Changes in Retained Earnings for Special Purpose Authorities are for those dividends paid to policy holders. The financial statements of the

SCIF, which are included as a component unit, are as of and for the year ended December 31, 1995.

The accounts of the remaining special purpose authorities are reported using the accrual basis of accounting. Under the accrual basis, revenues are recognized when they are earned, and expenses are recognized when they are incurred.

**Fixed Assets—Property and Depreciation:** Depreciation on buildings for the SCIF is computed on a straight-line basis over the estimated useful lives of the buildings (40 to 50 years). Data processing equipment owned by the SCIF is carried at cost less accumulated depreciation computed on a straight-line basis over the estimated useful lives of the equipment (three to five years).

**Cash and Pooled Investments and Investments:** The cash and pooled investments of the special purpose authorities are primarily invested by the State Treasurer as part of the State's pooled investment program. At June 30, 1996, the special purpose authorities cash and pooled investments were approximately 3% of the State's pooled investment portfolio described in Note 3. Additionally, state law, bond resolutions, and investment policy resolutions allow the authorities to invest in United States government securities, Canadian government securities, state and municipal securities, commercial paper, corporate bonds, investment agreements, and other investments.

All investments reported as of June 30, 1996 are categorized in three categories of credit risk:

1. Insured or registered, or securities held by the authority or its agent in the authority's name.
2. Uninsured and unregistered, with securities held by the counterparty's trust department or by an agent in the authority's name.
3. Uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the authority's name.

Table 35 presents the carrying value and market value of the investments of the special purpose authorities that were reported to the State on June 30, 1996.

Included in the investments of the special purpose authorities are the investments of the SCIF as of December 31, 1995. The SCIF represents 86% of the carrying value and 86% of the market value of the authorities' investments.

**Table 35****Schedule of Investments - Special Purpose Authorities**

June 30, 1996 (Amounts in thousands)

Invested Funds Subject to Categorization	Category			Carrying Value	Market Value
	1	2	3		
Government Securities:					
U.S. and U.S. agency.....	\$ 3,677,075	\$ —	\$ —	\$ 3,677,075	\$ 4,043,186
Canadian government.....	39,642	—	—	39,642	43,987
State and municipal.....	25,067	—	—	25,067	25,262
Commercial paper.....	4,500	—	—	4,500	4,500
Corporate bonds.....	2,070,652	—	—	2,070,652	2,175,249
Investment agreements.....	—	308,262	—	308,262	308,262
Money market.....	187,745	—	4,098	191,843	191,843
<b>Total Invested Funds Subject to Categorization.....</b>	<b>\$ 6,004,681</b>	<b>\$ 308,262</b>	<b>\$ 4,098</b>	<b>6,317,041</b>	<b>6,792,289</b>
<b>Separately Invested Funds Not Subject to Categorization</b>					
Investment agreements.....				576,740	576,740
<b>Total Investments.....</b>				<b>\$ 6,893,781</b>	<b>\$ 7,369,029</b>

**Due from the Primary Government:** The Due from the Primary Government account balance reflects \$10 million that is due to the SCIF from the State's General Fund.

**Restricted Assets:** Cash and pooled investments of \$373 million and investments of \$963 million were restricted for debt service.

**Fixed Assets:** Table 36 presents property and data processing equipment for the authorities.

**Table 36****Schedule of Fixed Assets - Special Purpose Authorities**

June 30, 1996 (Amounts in thousands)

Real estate:	
Office building.....	\$ 335,245
Land.....	37,119
Furniture and equipment.....	62,870
Construction in progress.....	1,133
<b>Total Fixed Assets.....</b>	<b>436,367</b>
Less: Accumulated depreciation.....	(98,858)
<b>Net Fixed Assets.....</b>	<b>\$ 337,509</b>

The schedule of fixed assets does not include certain unaudited fixed assets of the Non-Major Component Units totaling approximately \$194 million.

**Revenue Bonds:** Under state law, the CHFA may issue revenue bonds. The bonds issued by the CHFA allow the State to make loans to finance housing developments and to finance the acquisition of homes by low to moderate income families. When the housing development and home loans financed by the revenue bonds are

fully paid, the housing developments and homes become the property of private individuals or entities. Principal and interest on the revenue bonds issued by the CHFA are payable from its earnings.

**Changes in Bond Indebtedness:** Table 37 summarizes the changes in revenue bond debt of these authorities for the year ended June 30, 1996.

**Table 37****Schedule of Changes in Revenue Bond Debt - CHFA**

Year Ended June 30, 1996 (Amounts in thousands)

Balance, July 1, 1995.....	\$ 3,750,981
Additions.....	1,002,452
Deduction.....	(415,678)
<b>Balance, June 30, 1996.....</b>	<b>\$ 4,337,755</b>

**Debt Service Requirements:** Table 38 shows the debt service requirements for revenue bonds, excluding interest. Total interest payments for the year ended June 30, 1996, was \$253 million.

**Table 38****Schedule of Debt Service Requirements - CHFA**

Year Ending June 30 (Amounts in thousands)

1997.....	\$ 54,465
1998.....	67,645
1999.....	72,625
2000.....	78,106
2001.....	88,136
Thereafter.....	3,988,895
<b>Total.....</b>	<b>\$ 4,349,872</b>

**Extinguishment of Debt:** On May 8, 1996, the CHFA issued Home Mortgage Revenue Bonds 1996 Series A, of which a portion of the proceeds were put into an escrow account to redeem Home Mortgage Revenue Bonds 1986 Series A. The CHFA considered this debt refunding to be an in-substance defeasance and accordingly removed from the combined balance sheet the bonds payable as well as the assets required to effect the redemption. In accordance with GASB No. 23, "Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities," the loss from the debt refunding was deferred and will be amortized over the remaining life of the prior bonds, which is shorter than the estimated life of the refunding bonds. At June 30, 1996, \$92 million of bonds were considered defeased. The loss from extinguishment of debt was \$3 million.

The refunding will decrease the debt service cash outflow for Single Family (Home Mortgage Revenue Bonds) by approximately \$15 million. The refunding may also provide for an economic gain (present value of the difference between new and old debt service requirements) for Single Family, which is estimated to be approximately \$1 million.

**Commitments:** As of June 30, 1996, the CHFA has outstanding commitments to provide \$6 million for loans under the Multi-Unit Rental Housing Revenue Bonds I Program, \$38 million for loans under the Multifamily Housing Revenue Bonds II Program, and \$43 million for loans under the Home Mortgage Revenue Bonds Program.

At December 31, 1995, SCIF was committed under the terms of renewable leases for 18 offices. Table 39 summarizes the minimum annual rental commitments.

**Table 39**

**Schedule of Lease Commitments - SCIF**

Year Ending December 31 (Amounts in thousands)

1996.....	\$ 16,632
1997.....	14,997
1998.....	9,713
1999.....	6,430
2000.....	4,454
Thereafter.....	4,716
<b>Total.....</b>	<b>\$ 56,942</b>

**Subsequent Events:** From July 1, 1996, to November 27, 1996, the CHFA issued approximately \$214 million in revenue bonds.

**NOTE 27.**

**JOINT VENTURE**

A joint venture is an entity that results from a contractual arrangement and that is owned, operated, or governed by two or more participants as a separate and specific activity subject to joint control. In such an arrangement, the participants retain an ongoing financial interest or an ongoing financial responsibility in the entity.

The **Capitol Area Development Authority** (CADA) was created in 1978 by the Joint Exercise of Powers Agreement (JPA) between the State of California and the city of Sacramento for the location of state buildings and other improvements in the central city. The CADA is a public entity separate from the State and the city, and is administered by a board of five members: two appointed by the State, two appointed by the city, and one appointed by the affirmative vote of at least three of the other four members of the board. The State designates the chairperson of the board. Although

the State does not have an equity interest in the CADA, it has an ongoing financial interest in the CADA. Based upon the appointment authority, the State has the ability to indirectly influence the CADA to undertake special projects for the citizenry of the State. The State subsidizes the CADA's operations by leasing the lands to the CADA without consideration; however, the State is not obligated to do so. Separately issued financial statements of the CADA can be obtained from its administrative office at 1530 Capitol Avenue, Sacramento, California 95814.